Sustained Macroeconomic Stability

• In six years, Serbia has transformed to a low inflation and stable growing economy, with balanced fiscal position, declining public debt, significantly reduced external imbalances and labour market recovery.

• GDP growth in 2019 continued with strong economic expansion reaching a rate of 4.2%, as a result of faster growth of investment. Similar movements are expected for Q1 2020 with GDP growth of around 5.0%.

• Inflation in February stood at 1.9%, in line with NBS forecast. Inflation expectations are stable and anchored within the target tolerance band (3±1.5%).

• After a surplus in 2017 and 2018 government budget recorded deficit of 0.2% of GDP in 2019, maintaining primary balance in surplus (1.8% of GDP). Further decline of public debt share in January 2020 (48.9% of GDP, compared to 52.0% in 2019).

• Macroeconomic stabilization and improvements to the business environment contributed to high FDI inflows of EUR 7.3 bn in 2018 and 2019. Strong FDI inflow continued in January 2020 (EUR 245.3 mn).

• Exports of goods and services retained their growth momentum in January 2020 (growth of 14.7%), driven by exports of manufactured goods and services.

• Positive developments on labour market. Unemployment rate reached single/digit level of 9.7% in Q4 2019 (LFS), while employment rate reached highest level (49.7%).

• Results were acknowledged by improved credit ratings in 2019 (Fitch and S&P) and additionally improved outlook (Moody’s) and a continued decline in the country risk premium (minimum in December 2019). In 2018 a Policy Coordination Instrument with the IMF has been approved, with successfully completed third review.

• NBS decided to cut the key policy rate by 0.5 pp to 1.75%, taking timely and adequate response to heightened uncertainty in the international environment, especially to global growth, triggered by the spread of the coronavirus (Covid-19).

• Credit activity extended its steady and sustainable growth in 2020, which in January accelerated to 10.0% y-o-y.

• Banking sector stability has been preserved and further reinforced. Encouraged by the NBS measures, the share of NPLs in total loans declined to 4.10% at end-December 2019. Capital adequacy indicators are even stronger after the application of Basel III standards in Serbia.
Despite Higher GDP Growth and Positive Labor Market Developments, Inflationary Pressures Remain Low

Inflation profile similar to advanced economies…

- Inflation is kept firmly in check, moving around 2% on average in the past six years.
- The dynamics of inflation in 2019 was mainly led by unprocessed food prices and energy prices.
- In line with our expectations, inflation in the first two months moved around last years level (1.9% y/y in February).
- The biggest contribution to y/y inflation in February came from prices of services (0.8 pp), unprocessed food (0.6 pp) fresh meat and cigarettes (both 0.3 pp). Lower prices of vegetables acted in the opposite direction (-0.6 pp).

… same stands for core inflation

- Average core inflation in the last six years stood at 1.4%, confirming price stability.
- Driven by one-off price increase of phone services, core inflation increased at 1.5% in February.
- In following period we expect core inflation to remain on a similar level.
- Inflation expectations are stable and moving in the lower half of the target tolerance band (March 2.2%)
Inflation Stable Within the Target in the Medium Term

**Inflation will remain low and stable in the next two years**

Chart 3 *Inflation projection* (from February 2020 IR) (y/y rates, in %)

- Inflation is expected to move around the lower bound of the target tolerance band during H1 2020, and gradually approach the target midpoint thereafter.
- Risks are assessed to be symmetric and related to developments in the global commodity and financial markets and to a lesser extent, administered price growth, agricultural season and domestic demand.

**Inflation will approach the target midpoint from mid 2020 on the back of food prices**

Chart 4 *Inflation projection* (from February 2020 IR) (y/y rates in % and contributions in pp)

- Such inflation profile throughout this year will reflect the base effect of vegetable prices.
- In the medium run it will reflect growth in aggregate demand, unit labour costs and gradual recovery in euro area inflation.
**Strong GDP Growth Expected to Continue in Q1 2020**

Infrastructure projects and services are the main drivers of growth

- After slowdown in economic activity in H1 2019 due to negative external effects and temporary decline in industrial production, GDP growth picked up in H2, reaching 6.2% in Q4 2019.
- Highest contribution to growth in Q4 came from construction and service sectors, due to intensive road and railway infrastructure projects, building of the gas pipeline, as well as residential investment.
- Our projection for GDP growth of 5.0% for Q1 2020 is based on continuation of investment, rise in services, industrial recovery, as well as favorable monetary and financial indicators.

GDP growth led by fixed investment and sustainable consumption growth

- In the last two years, around 80% of growth came from fixed investment, adding on average 3.5 pp to annual growth.
- Consumption remained as planned, growing slower than the overall GDP, further improving the structure of the economy.
- In Q1 2020 we expect GDP to grow at similar pace, relying on domestic demand, predominantly fixed investment, with negative contribution form net exports.
- The main risk to projection in the short run arises from coronavirus and potential disruption of global chains.
Sustained Growth on the Back of Robust Investment Activity, Exports and Labour Market Recovery

GDP growth in 2019 surpassed expectations despite external challenges

In the coming years Serbia will maintain a strong, sustainable and broad-based growth

- Despite momentum loss across much of the Eurozone, and negative contribution of one-off effects, GDP growth in 2019 surpassed our expectations, reaching 4.2%, primarily driven by faster growth of fixed investment.
- Growth in the following years is expected to remain around the rate of 4%, supported by macroeconomic stability, improved business environment, strong private and public investment and effects of past monetary easing.
- Highest contribution to growth should come from fixed investment and private consumption, while net exports contribution will for some time remain negative, but in smaller amount, owing to rise in manufacturing exports.
- Risks to GDP growth in 2020 are assessed as symmetric. Those arising form international environment are judged to be skewed to the downside and primarily related to the pace of euro area growth and in the short-term effects of the coronavirus. On the other hand, the domestic factors, primarily related to the potential faster growth of investment, are tilted to the upside.
- New downside risk arises from coronavirus spread, which is already affecting economies across the world.
The Ongoing New Investment Cycle

Preceded by achieved macroeconomic stability, new investment cycle began in 2015…

Chart 9 Fixed investment share in GDP (real terms, in % of GDP)

- In 2015-2019, fixed investments grew at an average annual rate of about 10%, while their cumulative growth was about 63%.
- The fastest growth was made in 2018 and 2019, when fixed investments increased in real terms by 17.8% and 16.4%.
- The share of fixed investment in real GDP increased from 17.5% in 2014 to 24.3% in 2019, with the expected continuation of growth in the medium term.
- In the medium-run, investments will contribute to further rebalancing of the economy.

…supported by strong construction and fixed investments growth

Chart 10 Construction and fixed investments growth (real terms, in %)

- Sustained macroeconomic stability, improvement in the overall business environment, rising profitability and EU accession process will work in favour of private investments in the coming years.
- Aside from private investments, public sector investments recovered as of 2015 and picked up particularly in 2018.
- A growing economy, combined with improved tax collection and responsible public spending policies, will enable the government to increase investment activity and further develop the country’s infrastructure.
Macroeconomic and Financial Stability Supporting High FDI Inflow

Macroeconomic and financial stability combined with structural reforms has created a favourable climate for FDIs…

Chart 11 FDI composition by sector (EUR bn)

...which are diversified by sector and origin and contributing to the country’s export potential

Chart 12 FDI composition by origin (EUR bn)

- Out of a gross inflow of EUR 7.3 bn (EUR 6.7bn net) in 2018 and 2019, EUR 4.5 bn has been directed into tradable sectors, most notably manufacturing (EUR 1.9 bn).
- Within manufacturing, most FDI inflows are directed to the metals, motor vehicles, food/beverage and rubber industries. This resulted in high growth of manufacturing employment, output and exports.
- Serbia ranked first on Financial Times Greenfield FDI Performance Index for 2019, which looks at greenfield FDI inflows compared to the size of the economy.

- FDI inflows are diversified by region of origin as well, with a greater share of countries from the Asia Pacific and Middle East regions, alongside Serbia’s major investment partner - the European Union.
- During 2017 – 2019, the bulk of FDI inflows still came from Euro area countries (45.1%), but with an increasing share of Asian countries (16.4%) such as China/HK and the UAE, as well as non-EU European countries (20.8%) such as Russia, Turkey and Switzerland.
Exports Growth Will Remain a Key Factor of CAD Reduction Driven by Increased Manufacturing Capacity

Export growth continues despite Eurozone slowdown...

• During 2019 goods and services exports continued to post strong growth (10.5%) despite external pressures, driven by exports of manufactured goods, services and agriculture.

• According to January data, exports recorded growth of 14.7% on the back of manufacturing and services.

• Eurozone demand moderation was compensated by increasing exports to other markets and new productive capacities on the supply side.

• As a result of high FDI inflow in tradable sectors we expect double-digit growth in exports of goods and services in the coming years.

...but imports are growing faster on account of increased investments and industrial production

• As of 2017 Serbia is seeing a faster growth in imports on account of higher imports capital and intermediate goods related to investment and industrial activity, higher oil prices as well as further growth in domestic demand.

• Imports of goods and services grew 10.7% y/y in 2019, on account of higher imports of capital, intermediate as well as consumption goods.

• Additional one-off effects in 2019 came from imports of components for a natural gas pipeline which is to improve security of supply and reduce costs in the coming years.
Increased Geographical Diversification of Foreign Trade

Increased exports to Germany despite the slowdown of German economy…

- Serbia’s exports are largely directed towards EU and countries of the region. In 2019, about two thirds of Serbian exports went to the EU, followed by CEFTA and CIS.
- By country, the largest share of exports went to Germany (12.7%), followed by Italy (10.2%), Bosnia and Herzegovina (7.7%), Romania (5.8%) and Russia (5.0%).
- In 2019 compared to 2018, share of exports to the Italian market declined from 12.7% to 10.2%, while the share of exports to non-EU states increased.
- Although not yet among top 10, export to China are increasing at a triple digit rates

Germany is the largest import partner with growing importance of China…

- Majority of imports (around 60%) come from the EU, followed by CIS and CEFTA.
- By country, the largest shares of imports are from Germany (13.0%), China (9.1%), Italy (8.8%) and Russia (8.7%).
High Investment Growth Reflected in Current Account Deficit in 2019

The current account deficit peaked in 2019 and is projected to gradually decline as of 2020.

From a savings-investments perspective the CAD increase is entirely explained by higher investments.

- The CAD has increased to 6.9% of GDP in 2019, whereby the overall increase is a result of an increase in the share of investment in GDP.
- In addition, one-off effects on the CAD growth were also around 2% of GDP.
- Since 2015 Serbia’s current account deficit has been fully financed by net FDI, which we expect to be continued in the coming period.
- As a result of high FDI inflow, we expect double-digit growth in exports of goods and services in the coming years.

- During 2019 the share of gross domestic investments in GDP increased from 22.7% to 24.6% broadly in line with the CAD increase.
- In the same period gross national savings remained almost unchanged (17.8%, a decrease by 0.1 percentage points) – the negative effect of 100% taxes on goods delivered to Kosovo was offset by a reduction in personal expenditure share in GDP.
- The S-I gap since 2017 is driven by the private sector, while government savings and investments are mainly neutral (a result of the fiscal consolidation).
Labour Market Recovery and Productivity Growth

The unemployment rate remain at single-digit level in Q4 2019

- The unemployment rate remained at single digit level in Q4 2019 and was at 9.7%, down 3.2 p.p. compared to the same period of the previous year.
- The employment rate in Q4 was at record level of 49.7% (y/y growth of 2.3 pp).
- Growth in the number of employees also comes from the increase of the participation rate of 0.6 pp at y-o-y level, which in Q4 2019 was 68.7%.

Increasing contribution of total factor productivity to Serbian GDP growth

- In the period as of 2015, a positive contribution to GDP growth came from capital, labour and TFP.
- Growth acceleration in 2017-2018 was driven mainly by faster TFP growth. Labour contribution to growth declined compared to 2015-2016, compensated by a faster growth of the capital stock.
- In the medium term, we expect still lower contribution from labour, a higher capital contribution due to structural reforms, while TFP contribution will increase further to 2 pp supporting income convergence to developed countries.
Labour Market Recovery and Productivity Growth

Wage growth at double-digit level in 2019

• The average nominal net wage in December 2019 amounted to RSD 59,772 (EUR 509) and was 14.1% higher than in December 2018.

• At the level of the whole of 2019, the average net wage amounted to RSD 54,919 (10.6% y/y).

• By sectors, highest wage increase is recorded in financial and ICT, followed by manufacturing and construction.

• Wage increase in public sector was completely followed by private sector wage increase.

Dominant contribution of industry in formal employment

• Favourable trends in the formal labour market came from the private sector, where employment accelerated growth to 17.4%, ie 236 thousand persons (Jan 2020 / Dec 2014), primarily in manufacturing, private sector services and construction.

• Total formal employment increased by 10.6% over the same period (ie 210 thousand persons).

• At the same time, there is a rationalization of the number of employees in the public sector (a decrease of about 26 thousand persons, ie -4.2%).
Favourable Fiscal Performance Continues

Strong fiscal adjustment since 2015 of around 8 pp of GDP…

…resulted in a decline in the public debt-to-GDP ratio and its sustainability

- Improvement of the fiscal outlook in last four years was led by fiscal consolidation on expenditure side, and robust growth in revenues on account of GDP growth and improved tax collection.
- After two years of surplus, fiscal balance recorded deficit of 0.2% of GDP in 2019 which is better result than projected in the Fiscal strategy.
- Deficit was a result of intensive government investment, which grew at rate of 33.6% in 2019, reaching 4.9% of GDP, well above projection.

- The declining trend of public debt continued in January 2020 (48.9% of GDP, compared to 52.0% in 2019).
- The Fiscal Strategy entails a medium-term deficit target of 0.5% of GDP, consistent with steady debt to GDP reduction.
- Public debt dinarisation picked up from 20.9% (end-2016) to 27.7% in 2019.
- Serbia issued a 10y EUR 1bn Eurobond at 1.62% in June and an additional EUR 550mn at 1.25% in November, repaying USD-denominated bonds in the same amount, thereby further reducing exchange rate and rollover risk.
Key Policy Rate lowered to 1.75%, its' new lowest level in the inflation targeting regime

In March 2020, the key policy rate is cut by 50 bp to 1.75%

The decision takes into account the following factors:

- taking a timely and adequate response to heightened uncertainty in the international environment triggered by the spread of the coronavirus (Covid-19),
- favorable domestic factors, stronger downside risks to global growth from the international environment,
- providing the additional support to economic and credit growth.

FX required reserve ratio has remained unchanged since early 2016

- Last time FX RR ratio was reduced in early 2016 aiming to support lending activity (to 20%/13%, for liabilities up to/over 2Y).
- RR is an important monetary policy tool (in February 2020 RR amounted to EUR 2.1 bn and RSD 197.1bn).
- NBS uses RR as an important macroprudential tool within dinarisation strategy:
  - by applying lower RR ratio on dinar vs FX sources,
  - by applying remuneration at higher rate on dinar RR vs FX RR (i.e. 0.75% on RSD RR, while no remuneration is applied on FX RR).
The Effects of NBS Monetary Policy are Reflected in Lower Costs of Government and Private Sector Financing...

Interest rates on dinar government securities have slided to new minimums …

Chart 27 Interest rates in the primary market of government securities (p.a. in %)

Nov. 2019: 7Y (2.7%)
Feb. 2020: 5Y (2.6%)
March 2020: 12Y (3.35%)

… while interest rates on private sector loans are close to their lowest levels

Chart 28 Interest rates on loans – new business (p.a. in %)

Source: Ministry of Finance.
* Excluding coupon securities with the rate linked to the NBS key policy rate.

• The dinar yield rate curve is extended to 12 years in February, with decline of yield rate on 12y dinar bond to 3.35% in March.

• In auctions held in January and February, 5y dinar bonds were sold at 2.6%, which is 1.4 pp lower than a year ago.

• The share of long-term securities (5+ year maturity), increased from 2% in December 2012 to almost 80% at the beginning of 2020.

• In auction held in January 2020, Serbia issued for the first time EUR bond with the maturity of 20 years (with yield rate of 3.0%).

• Since the beginning of monetary policy relaxation cycle (May 2013), dinar lending interest rates fell sharply, which in January amounted to:
  - 2.9% for corporates (down by 13.6 pp)
  - 9.3% for households (down by 11.2 pp)

• The servicing costs of outstanding credit amounts have also been reduced, leading to higher disposable income for consumption and investments, of both households and corporates.

• In the observed period, a sharp fall in the country risk premium and the country’s credit rating upgrade, as well as monetary easing by the ECB contributed to the fall in EUR-indexed lending rates.
... as well as to Growth of Credit Activity

Lower costs of financing and sustainable economic growth support domestic lending …

• Lending activity extended its steady and sustainable growth in 2020, which in January, excluding the exchange rate effect, accelerated to 10.0% y/y.

• The structure of lending is favorable in terms of support to sustainable economic growth, as evidenced by a significant rise in corporate investment loans and a rebound in housing loans.

• Further growth of lending activity is expected in the coming period, as a result of sustainable economic growth, improved conditions in the labor market, effects of monetary policy easing by the NBS, low interest rates in the euro area, interbank competition and reduced NPLs.

... and the positive tendencies are also reflected in corporate loans market

• Since the beginning of H2 2019, corporate loans are providing the biggest contribution to y/y growth rate of total credit activity (5.2 pp in January 2020) and significant support to acceleration of economic activity.

• The strong increase of investment loans is providing the biggest impetus to the y/y growth rate of corporate loans (9.9% in January 2020), while their amount reached almost EUR 5 bn.

• Since May 2019, investments loans have become the largest category of corporate loans (with the share of 45.1% in January 2020), followed by loans used to finance current assets (with share of 39.3% in January 2020).
Serbia’s Credit Rating Improvement and Investor Confidence Growth

After reaching all-time low, Serbia’s risk premium stays among the lowest in the region

- Serbia’s risk premium reached its historical low level in December, and recorded the biggest fall in the region in 2019, indicating that it was also driven by domestic factors. The outbreak of the coronavirus in early 2020 triggered uncertainty in global financial markets and pushed the risk premia of emerging markets up.

- Fitch improved Serbia’s rating from BB to BB+, and Moody’s upgraded the outlook for credit rating to ‘positive’ from ‘stable’ (Ba3) in September 2019.

- S&P also upgraded Serbia’s credit rating from BB to BB+ in December, while at the same time assessing the outlook for further rating upgrade as positive, sending a positive signal to investors.

Appreciation pressures in previous years backed by strong domestic macroeconomic fundamentals

- In the previous three years the dinar cumulatively appreciated by 5% against the euro in nominal terms. Strengthening of the dinar is stimulated by better Serbia’s macroeconomic fundamentals, good performance and favorable growth prospects, which contributed to FX inflow on account of FDI and elevated non-resident investment in long-term dinar government securities. Since the beginning of 2020, the dinar stayed broadly unchanged against the euro.

- In order to maintain the relative stability of the dinar, the National Bank of Serbia was buying FX in periods of strong and concentrated appreciation pressures, acting proactively and bolstering the FX reserves, thus enhancing the resilience of the domestic financial system to external risks.
Indicators of Dinarisation are on the Rise

Macroeconomic stability contributing to dinarisation process

Chart 33 Dinarisation of the corporate and household sector receivables and deposits, and dinar share of public debt (in %)

- NBS stimulates the dinarisation process by delivering low and stable inflation, preserving relative exchange rate stability, enhancing management of FX risks and exposures in the private sector, and using other measures.
- The Government contributes to dinarisation through tax policy, by developing the dinar securities market (dinar debt share rose from 2.5% in 2008 to 27.9 % in January 2020).
- Dinarisation of corporate and household sector deposits rose by 15.1 pp compared to end-2012 and currently stands at 34.4% (January 2020), while dinarisation of corporate and household sector receivables rose by 5.1 pp to 33.1% (January 2020).

The growth of dinar loans to households accompanied by higher dinar savings

Chart 34 Dinarisation of corporate and household sector (outstanding amounts, in %)

- Over the past years, dinarisation of household receivables had a firm upward trend as a result of a sharp drop in dinar interest rates, low and stable inflation as well as NBS measures aimed to support dinarisation – an upsurge from 35.1% (2012) to the maximum of 55.3% (January 2020).
- Dinar savings of households (residents) recorded strong growth in past two years (22.2% in 2018 and 30.7% in 2019), which is also continued in 2020.
- In January 2020, household dinar savings increased by RSD 3.0 bn reaching the new maximum of RSD 82.0 bn (or RSD 82.6 bn including non residents).
Traditional Banking
Mostly Financed by Domestic Deposits

Adequate structure of banking sector assets

Chart 35 Structure of banking sector assets
(RSD bn)

Improving the quality of the banking sector assets

Chart 36 Asset quality – Non-performing loans (NPL)
(RSD bn, %)

• Risk aversion during the crisis led to more intensive investments in low-risk state securities, which after 2015 stabilized at around one-fifth of the total banking sector net assets (17.2% at the end of December 2019).

• Despite historical low levels of deposit rates, stability of retail and corporate deposits in funding mix is present, with share in total liabilities of 46% and 27%, respectively at the end of December 2019.

• Despite high loan portfolio euroization, currency matching of assets and liabilities is present, with net open position of 1.6% of regulatory capital at end of December 2019.

• Implementation of NPLs resolution measures together with the growth of credit activity led to a significant improvement of banks portfolio quality. The share of NPLs decreased to the lowest level since the 2008 when the definition and reporting requirements were introduced.

• At end-December 2019, the NPL ratio was 4.10%, with the maintenance of relatively high coverage by both, IFRS provisions (60.7%).

• The main channels for the NPLs reduction remained the write-off and transfer (sale) to third parties, with increasing contribution of repayment.

Source: NBS
Conservative Framework Contributed to the Banking Sector Resilience to Shocks

High banking sector capitalisation as a result of strong prudential measures

- Banks possess significant capital reserves, which enable them to successfully deal with credit risk even in the case of worst-case stress scenario.
- In addition to the high level, the capitalization of the banking sector is characterized by a strong structure, with CET1 around 95% of total capital.
- The high solvency of the banking sector is also indicated by the leverage ratio, introduced in regulatory framework of the Republic of Serbia with Basel III implementation, which at the end of September 2019 amounted to 13.7%.

Serbian banking sector is highly liquid

- Liquidity ratios are constantly at levels significantly higher than the regulatory minimum.
- Liquid assets account for around 37.2% of the total assets of the banking sector in December 2019.
- The loan to deposit ratio that at the end of December 2019 amounted 91.2%, indicates stability of funding and in general the liquidity of the banking sector.
Structural slides
Following the rating upgrade by Fitch in September, S&P has also upgraded Serbia’s rating from BB to BB+ in December, while at the same time assessing the outlook for further rating upgrade as positive.

The rating upgrades are the result of resilient economic growth in the face of the challenging external environment, strengthening of macroeconomic fundamentals, preserved fiscal discipline and adequate monetary and prudential policy measures.
Improved Structural Competitiveness Provided Additional Boost to Overall Macroeconomic Performance

Chart 39 Indicators on business regulation, DB (rank, lower value means rank improvement)

- Key reform areas in the last four years:
  - Construction sector;
  - Labor market;
  - Tax administration;
  - Financial sector;
  - Contract enforcement and resolving insolvency.

Chart 40 Global competitiveness indicators, WEF (rank, lower value means rank improvement)
Legal Framework for Banking Supervision

- **Domestic regulatory framework for banking supervision is based on Basel III standards:**
  - Set of by-laws implementing these standards on individual and consolidated level are applied as of 30 June 2017;
  - Since July 2017 further steps on harmonization of domestic legal framework with Basel III were made;
  - The main goals of implementing these standards are to increase the resilience of the banking sector by enhancing the quality of capital and introducing capital buffers, to increase the efficiency of monitoring and controlling banks’ exposure to liquidity risk, further strengthening of the market discipline and transparency of banks’ operation in the Republic of Serbia by publishing all relevant information on bank operation, as well as to bring the reporting system in line with the new regulatory arrangements
  - So far no issues have been identified in the application of Basel III standards;
  - NBS will continue to take regulatory activities in order to ensure alignment with EU acquis.

- In December 2017 **regulation governing risk management by banks was amended** with aim to improve the way bank deals with risks and enhance its Internal Capital Adequacy Assessment Process (ICAAP).

- Accounting and prudential regulations were timely adjusted in order to **enable the implementation of IFRS 9 in banks from 1st of January 2018**.

- Additionally, cooperation with supervisors of the home countries of banks present in Serbia is continuously developing and strengthening and regular communication with the ECB and EBA is maintained.
The Amendment of NPL Resolution Strategy by adoption of NPL Program for period 2018 - 2020

Effect of strategy on NPL stock

Effect of strategy on NPL ratio

- Aggregate decrease of NPL level in August 2015 – November 2019 amounts to RSD 325.6 bn, while the effect of the NPL Strategy is mostly reflected through the historically lowest level of NPL ratio of 4.10% at end-December 2019. Compared with NPL ratio before the NPL Strategy entered into the force (22.25%) the decrease is clearly impressive at 18.15 p.p.

- Beside successful implementation of NPL Strategy, it is necessary to perform activities intended for resolution of remaining problems in order to provide the sustainability of achieved results. For that purpose, it is very important to create the ambient, which strives for early detection of sources and causes of NPLs, as well as, upgrading of existing institutes directed toward resolution of potentially new NPLs. Bearing that in mind, the Government of the Republic of Serbia on the December 27th 2018 implemented a Program for NPL resolution for period of 2018 – 2020 (Program for NPL).

- As a integral part of Program for NPL, Action plan focuses on subjects of:
  - resolution of non-performing claims of state-owned financial creditors, through assignment of claims and eventually write-off of remaining part of portfolio;
  - improving bankruptcy framework, i.e. it`s upgrade as institute in non-performing claims resolution;
  - series of activities that are directed to the prevention of emerging and accumulating of new NPLs.
• Capital buffers increase the resilience of banks to losses, reduce excessive or underestimated exposures and restrict the distribution of capital.
• These macroprudential instruments should limit systemic risks in the financial system, which can be cyclical (capital conservation buffer and countercyclical capital buffer) or structural (capital buffer for a systemically important bank and systemic risk buffer).
• The following capital buffers are used in the Republic of Serbia:
  – Capital conservation buffer;
  – Countercyclical capital buffer, in order to mitigate and prevent excessive credit growth;
  – Capital buffer for a systemically important bank, with the objective to limit the systemic impact of misaligned incentives in terms of favoring certain financial institutions;
  – Systemic risk buffer, introduced to limit the risk of euroisation, one of the key structural non-cyclical systemic risks to the stability of the financial system of the Republic of Serbia.
• The capital conservation buffers may consist only of Common Equity Tier 1 capital equal to 2.5% risk-weighted assets for capital conservation buffer, 1% or 2% risk-weighted assets for capital buffer for systemically important banks, depending on the systemic importance level and 3% of total foreign currency and foreign currency-indexed placements of a bank approved to corporates and households in the Republic of Serbia for systemic risk buffer. Countercyclical buffer rate is set at 0%.
• Capital buffers apply as of 30 June 2017.
NPL Resolution Required a Systemic Approach – and, as Such, Gave Results

- NPL development after the adoption of the NPL Resolution Strategy, especially in 2017 and 2018, confirmed the soundness of the inter-institutional and coordinated approach envisaged by the Strategy.

- After 2018 drop in share of NPLs of 4.15 pp, noticeable downward trend continued in 2019, resulting with four times lower NPL ratio than it was at the time of Strategy adoption.

- Fall was widespread and recorded in all sectors, of which most prominent was within construction.

- The continuation of NPL resolution efforts by banks together with the recovery of credit activity, should further stimulate the decrease in the share of NPLs.

# NPL data, December 2019

<table>
<thead>
<tr>
<th></th>
<th>Gross loans (EUR bn)</th>
<th>Gross NPL (EUR bn)</th>
<th>NPL ratio (%)</th>
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<tbody>
<tr>
<td>Corporates</td>
<td>9.5</td>
<td>0.3</td>
<td>3.4</td>
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<tr>
<td>Natural persons</td>
<td>9.4</td>
<td>0.4</td>
<td>4.0</td>
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<tr>
<td>of which: households</td>
<td>8.5</td>
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<td>Corporates in bankruptcy proceedings</td>
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<tr>
<td>Other</td>
<td>2.1</td>
<td>0.1</td>
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<tr>
<td>Total</td>
<td>21.1</td>
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## Serbia’s Economic Outlook

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</thead>
<tbody>
<tr>
<td><strong>Real GDP, y-o-y %</strong></td>
<td>5.7</td>
<td>-2.7</td>
<td>0.7</td>
<td>2.0</td>
<td>-0.7</td>
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<td><strong>Private consumption, in %</strong></td>
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<td><strong>Private investment,¹ in %</strong></td>
<td>14.4</td>
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<td>-7.9</td>
<td>7.5</td>
<td>15.1</td>
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<td>10.1</td>
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<td><strong>Government consumption, in %</strong></td>
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<td><strong>Government investment, in %</strong></td>
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<td>7.6</td>
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<td><strong>Exports, in %</strong></td>
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<td>8.3</td>
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<td><strong>Imports, in %</strong></td>
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<td>-21.9</td>
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<td>-0.6</td>
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<td>5.1</td>
<td>4.0</td>
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<td>11.1</td>
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<td><strong>Unemployment Rate, in %⁴</strong></td>
<td>13.6</td>
<td>16.1</td>
<td>19.2</td>
<td>23.0</td>
<td>23.9</td>
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<td><strong>Nominal Wages, in %⁵</strong></td>
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<td><strong>Money Supply (M3), in %</strong></td>
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<td>21.5</td>
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<td>7.6</td>
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<td>11.6</td>
<td>3.6</td>
<td>14.5</td>
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<td><strong>CPI,² in %</strong></td>
<td>8.6</td>
<td>6.6</td>
<td>10.3</td>
<td>7</td>
<td>12.2</td>
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<td>1.7</td>
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<td><strong>National Bank of Serbia Key Policy Rate,³ in %</strong></td>
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<td>9.5</td>
<td>11.5</td>
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<td>8.0</td>
<td>4.5</td>
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<td>2.25</td>
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<td><strong>Current Account Deficit BPM-6 (% of GDP)</strong></td>
<td>20.0</td>
<td>6.3</td>
<td>6.5</td>
<td>10.3</td>
<td>10.9</td>
<td>5.8</td>
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<td>5.2</td>
<td>4.8</td>
<td>6.9</td>
<td>6.2</td>
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</table>

¹ Excluding the effect of change in inventories
² Inflation figures in the table represent Dec on Dec inflation: (Pt/Pt-12)*100-100
³ Latest data
⁴ Labour Force Survey. Since 2014, data are revised according to the new LFS methodology. Data for 2019 are calculated as average of four quarters.
⁵ Since 2017, nominal wages published according to the new methodology.
## Banking Sector Overview

### Serbia

<table>
<thead>
<tr>
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<tr>
<td><strong>Number of banks</strong></td>
<td>33</td>
<td>33</td>
<td>32</td>
<td>30</td>
<td>29</td>
<td>30</td>
<td>31</td>
<td>29</td>
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<td><strong>Employees</strong></td>
<td>29,887</td>
<td>29,228</td>
<td>28,394</td>
<td>26,380</td>
<td>25,106</td>
<td>24,257</td>
<td>23,847</td>
<td>23,055</td>
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<td><strong>Branches</strong></td>
<td>2,487</td>
<td>2,383</td>
<td>2,243</td>
<td>1,989</td>
<td>1,787</td>
<td>1,730</td>
<td>1,670</td>
<td>1,644</td>
<td>1,627</td>
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<td><strong>HHI Assets</strong></td>
<td>629</td>
<td>664</td>
<td>678</td>
<td>741</td>
<td>794</td>
<td>813</td>
<td>813</td>
<td>779</td>
<td>801</td>
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<td><strong>Share of foreign banks, %</strong></td>
<td>73.5</td>
<td>74.1</td>
<td>75.2</td>
<td>74.3</td>
<td>76.1</td>
<td>76.7</td>
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<td><strong>Assets (net), EUR m</strong></td>
<td>24,015</td>
<td>25,211</td>
<td>25,322</td>
<td>24,827</td>
<td>25,059</td>
<td>26,253</td>
<td>26,440</td>
<td>31,931</td>
<td>34,769</td>
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<tr>
<td><strong>Capital, EUR m</strong></td>
<td>4,720</td>
<td>5,104</td>
<td>5,198</td>
<td>5,186</td>
<td>5,122</td>
<td>5,631</td>
<td>5,725</td>
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<tr>
<td><strong>Loans (gross), EUR m</strong></td>
<td>15,324</td>
<td>17,204</td>
<td>17,273</td>
<td>17,140</td>
<td>16,170</td>
<td>16,442</td>
<td>17,565</td>
<td>19,406</td>
<td>21,110</td>
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<tr>
<td>Of which gross NPL, EUR m</td>
<td>2,592</td>
<td>3,275</td>
<td>3,217</td>
<td>3,483</td>
<td>3,491</td>
<td>2,800</td>
<td>1,730</td>
<td>1,105</td>
<td>865</td>
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<td><strong>Gross NPL ratio, %</strong></td>
<td>16.9</td>
<td>19.0</td>
<td>18.6</td>
<td>21.4</td>
<td>21.6</td>
<td>17.0</td>
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<td><strong>IFRS impairment of NPLs</strong></td>
<td>47.2</td>
<td>51.0</td>
<td>50.0</td>
<td>50.9</td>
<td>62.3</td>
<td>67.8</td>
<td>58.1</td>
<td>60.2</td>
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<td><strong>Deposits, EUR m</strong></td>
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<td>14,584</td>
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<td>15,067</td>
<td>15,637</td>
<td>15,242</td>
<td>19,236</td>
<td>23,115</td>
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<td><strong>Pretax Income</strong></td>
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<td>29.0</td>
<td>80.0</td>
<td>172.0</td>
<td>579.8</td>
<td>640.6</td>
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<td><strong>CAR⁵, %</strong></td>
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<td>19.1</td>
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<td>21.8</td>
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<tr>
<td><strong>GREEN impairment of NPLs</strong></td>
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<td>21.5</td>
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<tr>
<td><strong>Leverage⁶, %</strong></td>
<td>-</td>
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<td>11.1</td>
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<tr>
<td><strong>Liquidity ratio</strong></td>
<td>1.0</td>
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<td>2.1</td>
<td>2.4</td>
<td>2.2</td>
<td>2.1</td>
<td>2.1</td>
<td>2.0</td>
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<tr>
<td><strong>Liquidity coverage ratio⁴, %</strong></td>
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<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<td>239.5</td>
<td>213.3</td>
<td>199.7</td>
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<tr>
<td><strong>FX ratio, %</strong></td>
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<td>4.4</td>
<td>3.9</td>
<td>4.4</td>
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<td><strong>ROA², %</strong></td>
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<td><strong>Net interest margin⁵, %</strong></td>
<td>4.6</td>
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<td>3.3</td>
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2. Without Agrobanka at the end of 2011: Pretax profit €296m; ROA 1.2; ROE 6.0. Without Razvojna banka Vojvodina at the end of 2012: Pretax profit €230m; ROA 1.0; ROE 4.7

3. Thе last available data of 30.09.2019

4. Introduced by the implementation of Basel 3 and monitored from 30 June 2017

5. Net interest margin to average total asset